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IN THE  
**SUPREME COURT  
OF THE UNITED STATES**

OCTOBER TERM, 194<sup>4</sup>

NUMBER **1247**

**J. V. VANDENBERGE, ET AL., TRANSFERREES  
OF TEXAS AUTO COMPANY,**  
Petitioners,

VS.

**COMMISSIONER OF INTERNAL REVENUE,**  
Respondent.

**PETITION FOR WRIT OF CERTIORARI  
TO THE UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE FIFTH CIRCUIT AND BRIEF  
IN SUPPORT THEREOF**

By:

**J. V. VANDENBERGE, JR.**  
Of Counsel

**LEROY G. DENMAN,**  
Attorneys for Petitioners.



## INDEX TO SUBJECT MATTER

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	Page
Petition for Writ of Certiorari .....	1
I. Summary Statement of the Matters Involved	2
(a) Nature of Suit and Summary of Facts	2
(b) Question Presented .....	5
II. Reasons Relied on for the Allowance of the Writ .....	6
Brief in Support of Petition for Writ of Certiorari.....	8
I. Opinions of the Courts Below.....	8
II. Jurisdiction .....	8
III. Statement of the Case and Question Involved	8
IV. Specification of Errors .....	9
V. Argument .....	9
1. Cost Basis Under Revenue Act as Interpreted by The Tax Court and the Circuit Court .....	9
2. Conflict with the Arundel-Brooks and Detroit Edison Cases Discussed.....	12
3. General Principles of Law Applicable With Citation of Authorities .....	19

## INDEX TO AUTHORITIES

---

	Page
Arundel-Brooks Concrete Corporation vs. Commissioner, 129 Fed. (2d) 762 .....	6, 12, 13, 26
Andrews vs. Commissioner, 135 Fed. (2d) 314 .....	27
Berwind vs. Commissioner, 137 Fed. (2d) 451 .....	20
Brand vs. Commissioner, 5 B. T. A. 297 .....	25
Biscayne Company vs. Commissioner, 23 B. T. A. 731..	26
Commissioner vs. Gooch Milling & Elevator Co. Supra .....	28
Commissioner vs. Ashland Oil & Refining Company, 99 Fed. (2d) 588, 591; Certiorari denied, 306 U. S. 661 .....	19
Commissioner vs. Griffiths, 103 Fed. (2d) 110; Affirmed in 308 U. S. 355 .....	20
Couzens vs. Commissioner, 11 B. T. A. 1040 .....	25
Commissioner vs. Laughton, 113 Fed. (2d) 103 .....	27
Cosa Land Co. vs. Commissioner, 103 Fed. (2d) 555 .....	27
Detroit Edison Company vs. Commissioner, 131 Fed. (2d) 619; 319 U. S. 98 .....	6, 12 16, 17, 26

	Page
Eggink vs. Commissioner, 7 B. T. A. 152 .....	26
Early vs. Southgate Corp. 136 Fed. (2d) 217 .....	20
Esperson vs. Commissioner, 127 Fed. (2d) 370.....	27
Farming Corporation vs. Commissioner, 11 B. T. A. 1413 .....	23
Farmers Cotton Oil Co. vs. Commissioner, 27 B. T. A. ....	25
Farmers Loan & Trust Co. vs. Minnesota, 280 U. S. 204; 74 L. Ed. 371; 65 A. L. R. 1000 .....	27
Hague Estate vs. Commissioner, 132 Fed. (2d) 215; 318 U. S. 787 .....	27
Helvering vs. Taylor, 293 U. S. 507; 79 L. Ed. 623.....	27
Helvering vs. New Haven & S. L. R. Co. 121 Fed. (2d) 985, 988, certiorari denied, 315 U. S. 803..	19, 26
Helvering vs. Schine Chain Theaters, 121 Fed. (2d) 948 .....	25
Helvering vs. New President Corp. 122 Fed. (2d) 92 .....	26
James Mfg. Co. vs. Commissioner, 17 B. T. A. 205.....	25
Knight vs. Commissioner, 28 B. T. A. 188 .....	26
Legg's Estate vs. Commissioner, 114 Fed. (2d) 760....	27
Milton vs. Mackay, 11 B. T. A. 569 .....	26

	Page
McDonald vs. Commissioner, 28 B. T. A. 64.....	26
Majestic Securities Corp. vs. Commissioner, 129 Fed. (2) 12 .....	26
Nashville Warehouse & Elevator Co. vs. Commissioner, 105 Fed. (2d) 990 .....	18, 26
National Lumber & Tie Co. vs. Commissioner, 90 Fed (2d) 216 .....	27
Oats vs. First National Bank, 100 U. S. 239; 25 L. Ed. 580 .....	27
Perkins vs. Commissioner, 125 Fed. (2d) 150 .....	26
Park vs. Commissioner, 15 B. T. A. 106 .....	26
Prairie Oil & Gas Co. vs. Motter, 66 Fed. (2d) 309....	20
Robinson vs. Commissioner, 59 Fed. (2d) 1008 .....	26
Rosenbloom vs. Commissioner, 24 B. T. A. 763 .....	26
Robertson vs. Commissioner, 5 B. T. A. 748 .....	26
Seaside Imp. Co. vs. Commissioner, 105 Fed (2d) 990, 308 U. S. 618 .....	27
U. S. vs. Collier, 105 Fed. (2d) 420 .....	20
U. S. vs. Phellis, 257 U. S. 156; 66 L. Ed. 180 .....	20
Wagner & Son vs. Commissioner, 93 Fed. (2d) 816....	27

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J. V. VANDENBERGE, ET AL., TRANSFEREES  
OF TEXAS AUTO COMPANY,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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PETITION FOR WRIT OF CERTIORARI

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TO THE HONORABLE THE CHIEF JUSTICE AND  
ASSOCIATE JUSTICES OF THE SUPREME  
COURT OF THE UNITED STATES:

The petition of J. V. Vandenberg, D. E. Blackburn,  
and W. F. Wallace, transferees of Texas Auto Company,  
and Texas Auto Company, a Texas corporation, respectfully  
prays for a writ of certiorari to the United States Circuit  
Court of Appeals for the Fifth Circuit to review a judg-  
ment of that Court entered in this case on February 12,  
1945; and, as a basis therefor, shows as follows:

I.

**SUMMARY STATEMENT OF THE MATTERS INVOLVED.**

(a) Nature of Suit and Summary of Facts.

This proceeding is one to review a decree of the United States Circuit Court of Appeals for the Fifth Circuit affirming a decision of The Tax Court of the United States sustaining a determination by the Respondent of a deficiency in income and excess profits taxes against the Petitioner Texas Auto Company for the taxable years 1938 and 1939 in the following amounts:

<b>Taxable Year</b>	<b>Income Tax</b>	<b>Excess Profits Tax</b>
1938 .....	\$ 175.00	\$ 50.27
1939 .....	2,622.71	2,032.34
	<hr/> \$2,797.71	<hr/> \$2,082.61

And the consequent determination of liability therefor against the Petitioners Vandenberg, Blackburn and Wallace, as transferees of the Company. The four cases were consolidated by The Tax Court.

The controversy involves a determination of the Petitioner Texas Auto Company's "cost" of certain improved real estate purchased in 1922, as a basis for computing depreciation deductions claimed for the year 1938, and likewise as a basis for computing the gain realized from a sale of the property in 1939. The basic facts which give rise to the controversy are tersely, but none the less accurately, stated in the Circuit Court's opinion as follows:

"In 1922 the Texas Auto Company purchased certain improved real estate. As consideration for the transfer, the Company paid notes aggregating \$20,000.00 that were secured by liens on the property, and in addition secured the cancellation and return to the seller of unsecured notes aggregating \$24,567.16, liabilities of the seller and "his business associates, held by the City National Bank, of Corpus Christi, Texas". (R. 59).



Upon a sale of the property in 1939 for \$36,000.00, the respondent disallowed, as part of the 1922 cost, the amount of the unsecured notes, cancellation of which was obtained as a part of the consideration. Petitioners contended and now contend that the **cost basis** was \$44,567.16, \$25,000.00 representing cost of the building, and the remainder the cost of the land. Respondent confined his allowed cost to \$20,000.00, the amount of the secured notes actually paid off in cash by the Auto Company, and was therein upheld by both The Tax Court and the Circuit Court. (R. 36,60). In other words, the Circuit Court held that while the cancellation of the unsecured notes was a part of the consideration, the amount thereof was not a part of the 1922 **cost**.

The circumstances under which the unsecured notes were cancelled have a material bearing on the question involved, but the Circuit Court's opinion does not adequately reflect them. The case was decided by The Tax Court upon a stipulation of facts which are here presented as briefly as practicable consistent with clearness and accuracy.

In December of 1922 the Petitioner Texas Auto Company purchased the improved realty in question from the J. C. Blacknall Company. At that time one J. C. Blacknall was operating his business under his individual name and through the medium of three associate companies, including said J. C. Blacknall Company, the then owner of the property. (R. 33).

The J. C. Blacknall Company, at the time of the conveyance, owed two notes, each for \$10,000.00, secured by liens against the realty. Also, at the time of the conveyance, said Blacknall and his associates were indebted to the City National Bank, of Corpus Christi, Texas, to the extent of some \$24,567.16, evidenced by six unsecured notes. (R. 33, 34).

Clark Pease, at the time of the 1922 conveyance, owned 45 per cent of the Texas Auto Company stock and subse-

quently acquired all the remainder. Likewise, Pease owned 315 out of 345 shares outstanding of the stock of City National Bank. In other words, Pease owned 21/23 of the bank stock. Pease and his bank made an agreement with Blacknall and the latter's associate companies that if Blacknall should have the realty involved conveyed to the Auto Company, Blacknall and associates would be released from all liabilities direct or indirect, to either Pease or his bank. (R. 34).

Pursuant to agreement, a conveyance of the property was made, reciting on its face a consideration of \$10.00 "and other valuable consideration", and "subject to all existing indebtedness thereon". The two notes aggregating \$20,000.00 and secured by liens on the property were paid off by the Auto Company, and, in accord with the agreement had between Pease and his bank, on the one hand, and Blacknall and his associates, on the other, the latter's unsecured notes to Pease's bank, aggregating \$24,567.16, were cancelled and surrendered to Blacknall: In evidence of such cancellation, Pease's bank, in its federal income tax return for 1922, charged off an indebtedness of \$25,000.00 against Blacknall and his associates, including the unsecured notes referred to above. (R. 33-34).

The cost of the real estate so acquired in 1922 was set up by the Auto Company in the ensuing year at \$45,000.00, with \$20,000.00 allocated to the land, and \$25,000.00 to the building for depreciation purposes. Depreciation on the building, on such cost basis of \$25,000.00 was subsequently claimed and allowed by the Respondent for income tax purposes for the years 1923 to 1937, inclusive, for an aggregate of \$16,417.30. Depreciation in the amount of \$1,400.00 for the year 1938 was claimed, but disallowed by the Respondent when, after a sale of the property, the Respondent decreased the theretofore accepted and recognized "cost" of the property to \$20,000.00. The realty was

sold by the Auto Company in 1939 for \$36,000.00 in cash. (R. 34-35).

In his determination of the deficiencies in question, the Respondent allowed an original cost of only \$20,000.00, represented by the two secured notes above referred to, but the Respondent declined to allow the asserted additional cost of approximately \$25,000.00 represented by the six unsecured notes which were charged off by the bank. The Respondent apportioned his allowed cost of \$20,000.00 in the same ratio in which the Auto Company had apportioned its asserted cost of \$45,000.00, i.e. 20/45 for the land and 25/45 for the building, the Respondent allocating \$8,888.89 to cost of the land and \$11,111.11 to cost of the building, while the Auto Company allocated \$20,000.00 to cost of the land and \$25,000.00 to cost of the building. (R. 35).

The Respondent ruled that the building had been fully depreciated by the deductions aggregating \$16,417.30 prior to the allowance claimed for 1938. In computing gain from the 1939 sale, he allocated \$26,000.00 for the land and \$10,000.00 for the building. He consequently held that the taxable gain therefrom was the selling price, \$36,000.00, less the cost of the land, \$8,888.89, or \$27,111.11 (R. 35, 59).

Petitioners do not dispute Respondent's allocation of the selling price, but dispute his determination of the cost basis.

(b) Question Presented.

The sole question presented herein is whether, under the undisputed evidence, the amount of \$24,567.16 evidenced by the six promissory notes owed by Blacknall and his associates to the City National Bank, which the Bank and Pease agreed to and did charge off and surrender to Blacknall as a part of the consideration for Blacknall's conveyance of the property to the Auto Company, Constituted a part of the original 1922 "cost" of the improved realty involved, for the purpose of computing depreciation and gain under the Revenue Act.

II.

REASONS RELIED ON FOR THE ALLOWANCE  
OF THE WRIT

(a) The decision of the Circuit Court of Appeals is in direct conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Arundel-Brooks Concrete Corporation vs. Commissioner*, 129 Federal (2d) 762, wherein it has held, in construing the relevant sections of the Revenue Act here involved, that even though part of the money be donated by an interested party, the total cost of the asset, **not the net cost to the taxpayer**, is the proper basis to be used in determining depreciation as well as gain or loss, if the asset belongs solely to the taxpayer.

(b) The decision of the Circuit Court of Appeals is in direct conflict with the principles announced by this Honorable Court in *Detroit Edison Company vs. Commissioner*, 319 U. S. 98, wherein it was held that in computing depreciation under the relevant sections of the Revenue Act here involved, a property may have a cost history **quite different from its cost to the taxpayer**, the purpose of a fair tax administration being

“to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets”.

(c) The Tax Court and the Circuit Court of Appeals, in confining “cost”, as that term is used in applicable provisions of the Revenue Act prescribing a basis for computing depreciation and gain or loss resulting from a sale, to “actual cost to the taxpayer”, has so far departed from the accepted and usual course followed in the administration of the revenue laws, as to call for the exercise of this Court’s power of supervision.

WHEREFORE, your Petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals

for the Fifth Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the Record and all proceedings in this cause, numbered and entitled on its docket, No. 11,075, J. V. Vandenberg, et al, Transferees of Texas Auto Company, vs Commissioner of Internal Revenue, to the end that this said cause may be reviewed and determined by this Court according to law; and that your Petitioners may have such other and further relief as to the Court may seem proper and in conformity with law.

Respectfully submitted,

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## **BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI**

### **I.**

#### **OPINIONS OF THE COURTS BELOW**

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported in 147 Federal Reporter (2nd Series), page 167 (Advance Sheet No. 2, issued April 2, 1945). It will be found on pages 58 to 61 of the Record. The findings of fact in the opinion of The Tax Court of the United States are not yet reported in the bound volume of The Tax Court of the United States Reports, but will be found on pages 30 to 42 of the Record.

### **II.**

#### **JURISDICTION**

1. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938; Sec. 347 U. S. Code, Title 28.

2. The judgment of the Circuit Court of Appeals was entered on February 12, 1945, (R. 58, 62).

3. The nature of the case, the rulings of The Tax Court of the United States, and of the Circuit Court of Appeals for the Fifth Circuit, and the reasons why a writ of certiorari should be granted, are set forth in the foregoing petition.

### **III.**

#### **STATEMENT OF THE CASE AND QUESTION INVOLVED**

The petition for the writ of certiorari contains a statement of the case and of the question involved, as well as of all the facts material to its consideration and determination.

#### IV.

#### SPECIFICATION OF ERRORS

The Circuit Court of Appeals for the Fifth Circuit, by affirming the judgment and decision of The Tax Court of the United States over the grounds of error assigned by the Petitioners, committed errors which Petitioners here assign in this Court as follows:

1. The Court erred in confining the cost basis of the property in question to the amount of \$20,000.00 actually paid in cash, for purposes of computing depreciation and gain, and in disallowing, as a part of the cost, the amount of \$24,567.16 represented by the six promissory notes, the cancellation of which was a part of the consideration for the conveyance to Petitioner Texas Auto Company. (Assigned in Circuit Court as Error I, R. 49).

2. The undisputed evidence, as shown by the stipulation, having shown that the cost of the property in question to Petitioner Texas Auto Company was \$44,567.16, of which amount \$25,000.00 represented the cost of the building, the Court erred in confining the **cost basis**, for purposes of computing depreciation and gain, to the amount of \$20,000.00, and in allowing only \$11,111.11 as cost of the building and only \$8,888.89 as cost of the land. (Assigned in Circuit Court as Error II, R. 49).

#### V.

#### ARGUMENT

1. Cost Basis Under Revenue Act as Interpreted by The Tax Court and the Circuit Court.

The Petitioner Texas Auto Company, when referred to alone as the taxpayer, will be referred to as the Auto Company. Also, in view of the frequent references to the City National Bank of Corpus Christi, it will be referred to as the Bank, as in the opinions of The Tax Court and the Circuit Court.



The two specifications of error present the one question involved, i.e. whether or not the amount of \$24,567.16 evidenced by the six promissory notes owed by Blacknall and his associates to the Bank, which the Bank and Pease (Pease being the owner of the Bank and likewise a substantial owner of the Auto Company) agreed to and did charge off and surrender to Blacknall as a part of the consideration for the latter's conveyance to the Auto Company, constituted a part of the original 1922 "cost" of the improved realty involved, for the purpose of determining depreciation and gain under the Revenue Act.

The Tax Court and the Circuit Court have held that the "cost" basis is limited to the amount of money actually paid out by the Auto Company for the property, i.e. \$20,000.00 in retirement of the two \$10,000.00 notes secured by liens thereagainst. The Tax Court stated (R. 36) "that is all the petitioners ever paid for the property" which became in the Circuit Court's opinion

"The only consideration paid by the purchaser was \$20,000.00." (R. 60).

In other words, both The Tax Court and the Circuit Court have held that the term "cost" as used in the applicable provisions of the Revenue Act is confined to "actual cost to the taxpayer," or more explicitly "net cost to the taxpayer."

No such restricted meaning of the term "cost" was intended under the Revenue Act, no such construction thereof has been accorded by the Courts, and such construction has been and is denied under the conflicting decisions cited in the foregoing petition for writ.

The applicable sections of the Revenue Act of 1938, identical in all respects with the corresponding sections of the 1936 Act which were before the Court in the Arundel-Brooks and Detroit Edison cases, cited *supra* as being in



conflict with the decision in the instant case, are as follows:

\* \* \* \* \*

"Sec. 23 Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

\* \* \* \* \*

(1) Depreciation. A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. \* \* \*

"Sec. 113. Adjusted basis for determining gain or loss.

"(a) Basis (unadjusted) of property.

The basis of property shall be the cost of such property; except that—

\* \* \* \* \*

"(2) Gifts after December 31, 1920. If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis so determined or the fair market value of the property at the time of the gift, whichever is lower. \* \* \*

\* \* \* \* \*

(8) Property acquired by issuance of stock or as paid in surplus. If the property was acquired after December 31, 1920, by a corporation—

"(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

\* \* \* \* \*

"(b) Adjusted basis. The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

"(1) General Rule. Proper adjustment in respect of property shall in all cases be made—

"(B) In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws.

\* \* \* \* \*

"Sec. 114. Basis for Depreciation and Depletion.

"(a) Basis for Depreciation. The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in Section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property."

\* \* \* \* \*

## **2. Conflict With The Arundel-Brooks and Detroit Edison Cases Discussed.**

The direct conflict of the holding by the Circuit Court of Appeals for the Fourth Circuit in the case of Arundel-Brooks Concrete Corporation vs. Commissioner, 129 Federal (2d) 762, is immediately apparent. In the latter case it was held that

"The total cost of the asset, not the net cost to the taxpayer, is the proper basis to be used in determining depreciation as well as gain or loss."

The Circuit Court of Appeals in the instant case has held that

"The only consideration paid by the purchaser was \$20,000.00," (R. 60).

In delimiting the Auto Company's cost basis to \$20,000.00 the amount of the two secured notes actually paid off by the Auto company, The <sup>72</sup> Court based its decision on the opinion of the Circuit Court of Appeals in the case of Detroit Edison Company vs. Commissioner, 131 Federal (2d) 619, which was affirmed by the Supreme Court in

319 U. S. 98 (R. 39), but the affirmance by the Supreme Court was not on any ground conflicting with the Arundel-Brooks case as to the point in issue.

The Circuit Court in the instant case did not cite any supporting authorities, but, having affirmed the decision of The Tax Court, it is presumed that it likewise relied upon the Detroit Edison case.

In so holding, we submit that The Tax Court and the Circuit Court have clearly fallen into error, with an erroneous conception of the effect of the decision in the Detroit Edison case. Manifestly, each case involving a determination of cost basis must stand on its own merits. The facts of the Arundel-Brooks and Detroit Edison cases are readily distinguishable and, notwithstanding the Circuit Court's statement in the Detroit Edison Co. case that its conclusion was in conflict with the Arundel-Brooks case, it is apparent from reading the Supreme Court's opinion in the former that there was no such conflict. The Supreme Court did not overrule the Arundel-Brooks case, but on the contrary agreed with the latter case as to the proper rule of determining "cost" of property in computing gain or fixing depreciation. In the latter case, it was held that under the facts cost basis was not confined to the taxpayer's actual cost, whereas in the Detroit Edison Co. case it was held, **under the facts in that case**, that actual cost to the taxpayer properly represented its cost basis.

The facts in the Arundel-Brooks case parallel the facts in the instant case. Those in the Detroit Edison Co. case are not at all similar.

The Arundel-Brooks case, 129 Fed. (2d) 762, presented an identical question, at least in so far as Sec. 113 (a) (2) of the 1936 Act was applicable, the Court deciding the issue on the basis thereof and without regard to the "contribution to capital" section above quoted [Sec. 113 (a)

(8) (B)]. In that case, two corporations participated in a transaction leading up to the erection of a concrete mixing plant, toward which one contributed to the other (the taxpayer) \$20,000.00 of the total cost of some \$40,000.00. A third corporation owned all the stock of the taxpayer corporation and 25% of the stock of the contributing corporation. (In the instant case, it will be remembered that Pease owned 45% of the stock of the taxpayer Auto Company, subsequently acquiring the remainder, and likewise owned 315 shares out of the 345 outstanding shares of stock in the Bank which charged off the Blacknall notes as a part of the agreed consideration for the conveyance to the Auto Company of the realty in question). The three corporations in the Arundel-Brooks case had interlocking directorates. The Commissioner, as did the Board of Tax Appeals, interpreted the term "cost" as used in the statute to mean the **taxpayer's cost and no other**, and denied the taxpayer the right to depreciate on the basis of the total cost, including the contribution, confining such right to the net cost to the taxpayer, exclusive of the \$20,000.00 contribution. The Circuit Court of Appeals (Fourth Circuit), in reversing the Board and upholding the petitioner's right to depreciate on the basis of the total cost including the contribution, said in part as follows:

"And even though part of the money was donated by an interested party, the total cost of the asset, not the net cost to the taxpayer, is the proper basis to be used in determining depreciation as well as gain or loss, if the asset belongs solely to the taxpayer."

The Circuit Court, in so holding, called attention to the fact, which is true in the instant case, that there was no evidence of a joint venture between the contributor and the taxpayer, and further said in its opinion:

"To the contrary, the plant was erected by the petitioner for use in its own business. No consideration ever flowed from petitioner to Maryland Slag for the contribution. Nor was there any right, title,

interest or control in or over the plant vested in Maryland Slag by virtue of the contribution. Thus, if petitioner cannot take a depreciation of the \$20,000.00, no one can. Such a result would seem to violate the plain provisions of the statute, the ordinary dictates of common fairness, and the accepted standards of sound business practice."

The Arundel-Brooks case, plainly holds that in fixing "cost" of property as a basis for depreciation or computing gain or loss from a sale thereof, the statute **does not mean cost to taxpayer**, but does mean the **amount invested** in the acquisition or construction of the property by either the taxpayer, a donor, or a contributor, or all of them combined—in other words the entire amount of money expended in its acquisition.

In seeking to distinguish the case at bar from the Arundel-Brooks case, The Tax Court held that,

"\* \* \* the Maryland Slag Co. did actually contribute \$20,000.00 cash toward the erection of the plant, whereas in the instant case we would be unable to hold that either the Bank or Pease contributed anything of value toward the purchase price paid by Auto Company for the property in question."

As a predicate for such holding, in referring to the six Blacknall notes aggregating \$24,567.11 charged off by the Bank, The Tax Court stated that there was no evidence that they had any value, the "inference" being to the contrary (R. 38, 39). On this point, the Circuit Court held that

"The notes surrendered to the seller by the Bank were found by The Tax Court to be utterly valueless."

The "inference" thus drawn by The Tax Court, and upheld by the Circuit Court, was drawn from the mere fact that the notes were charged off by the Bank, pursuant to the agreement of it and Pease <sup>to do</sup> so in return for Blacknall's conveyance of the property. We submit that this holding and the inference so drawn by The Tax Court and the Circuit

Court are unjustifiable by and at variance to the stipulated facts. The notes were worth their face value as used. Blacknall owed the money, owned the \$45,000.00 value in the property, and he paid his debts in full by the conveyance of the property. There is nothing in the record to suggest that Blacknall would have conveyed the property to the Auto Company but for (1) its assumption of the lien indebtedness thereagainst in the amount of \$20,000.00, and (2) the discharge or surrender by the Bank (a corporation practically owned by Pease, the latter also owning 45 per cent of the Auto Company stock) of his unsecured notes aggregating some \$25,000.00.

The case of **Detroit Edison Co. vs. Commissioner**, 131 Federal (2d) 619, affirmed by the Supreme Court in 319 U. S. 98 and solely relied upon by The Tax Court in support of its decision, and presumably by the Circuit Court, involved facts wholly dissimilar to those in the Arundel-Brooks and Nashville Warehouse cases and the case at bar. The Detroit Edison Company was a public utility corporation, engaged in the generation of electric energy and its distribution to the public. When applications for extensions were received from prospective customers, it would undertake to provide the service by requiring the applicants to pay the estimated cost of the necessary construction. The company sought to recover through depreciation, as a part of its **cost** of the properties, the amounts so paid by the customers, invoking the provisions of Section 113 (a) (2) and Section 113 (a) (8) (B) of the Act, relating respectively to gifts and contributions to capital. The Commissioner and Board of Tax Appeals disallowed the depreciation so claimed.

The Sixth Circuit Court, in affirming, denied that either provision was applicable, in the first instance on the ground that the funds involved were not gifts or gratuities under Section 113 (a) (2), but supported by considerations, the

customers expecting "full remuneration" by use of the electric energy, and in the second instance on the ground that the funds were to be used for the "express purpose of constructing improvements," could have been reclaimed by the prospective customers upon an abandonment of the project, and therefore could not be considered as a contribution to capital.

The Circuit Court did state in its opinion that its conclusion was in conflict with the Arundel-Brooks case, basing such statement (purely obiter dicta in view of the clear distinction between the two cases) entirely upon the proposition that

"The word 'cost' as used in Section 113 (a) beyond question refers to the cost of the property to the taxpayer."

The Supreme Court granted certiorari for the reason, as stated in its opinion, **Detroit Edison Co. vs. Commissioner**, 319 U. S. 100, that the Circuit Court's decision "appeared" to conflict with the Arundel-Brooks case. That no actual conflict was found, with the exception of the incorrect statement of the law by the Circuit Court as above quoted, is clearly apparent from the Supreme Court's opinion. It affirmed the decision of the Circuit Court upon the ground that **under the facts** of the Detroit Edison Company case the funds involved were not subject to depreciation, either as gifts or as contributions to capital under the Sections invoked. However, the Supreme Court in effect overruled the above quoted proposition of law announced by the Circuit Court, interpreting "cost" to mean "cost to the taxpayer," in the following language:

"A property may have a cost history quite different from its cost to the taxpayer. It may have been purchased for less or more than the original cost, or built by contract which called for payments on which the builder profited greatly or suffered great loss, but generally, and in this case, the Commissioner was in



no error in ruling that the taxpayer's outlay was the measure of his recoupment through depreciation accruals."

Furthermore, in explaining the purpose of the law, the Supreme Court said:

"The end and purpose of it all is to approximate and reflect the financial consequence to the taxpayer of the subtle effects of time and use in the **value of his capital assets.**"

And in commenting on the facts there involved, further said:

"It is enough to say that it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company \* \* \* The payments were to the customer the price of the service."

The Supreme Court thus in effect agreed with the decision in the Arundel-Brooks case to the effect that the term "cost" as used in the statute refers to the **cost of the property** and not necessarily to the **cost to the taxpayer**, each case of course resting on its own facts. The Supreme Court did not in anywise overrule the Arundel-Brooks case, which would have followed as a matter of course had it concurred in the assertion by the Circuit Court that the latter's conclusion was "in conflict" with the Arundel-Brooks case. To the contrary, it inferentially approved and upheld the holding in the Arundel-Brooks case by the language as to "cost history" above quoted.

Cited in support of the decision in the Arundel case, is the case of **Nashville Warehouse & Elevator Corp. vs. Commissioner**, 105 Federal (2d) 883, likewise in point in the case at bar, wherein was involved the question of whether proceeds from an insurance policy, the property having been destroyed by fire, should, for the purpose of computing gain, be included in arriving at "cost" to the petitioner. The Board allowed only the "net cost to the petitioner", ex-



cluding the insurance money, and the Circuit Court in reversing and allowing a cost which included the insurance proceeds, said:

“Whatever the source of the funds from which payment was made, the cost was \$40,000.00.”

In the case at bar, if the consideration contended for, including the six promissory notes charged off by Pease's Bank, was not actually paid in full by the Auto Company, then the amount unpaid was, through his Bank, contributed to it by Pease, a stockholder, precisely the same character of contribution as had been made in the Arundel-Brooks case, source considered, with no strings tied.

### 3. General Principles of Law Applicable With Citation of Authorities.

The essential nature of the transaction under examination in this cause was the purchase or acquisition by the Auto Company of the realty in question. Where such is the case, the well established rule is that the transaction must be viewed as a whole. It is thus well stated in **Commissioner vs. Ashland Oil & Refining Company**, 99 Federal (2d) 588, 591, certiorari denied, 306 U. S. 661:

“It has been said too often to warrant citation that taxation is an intensely practical matter, and that the substance of the thing done and not the form it took must govern. \* \* \* And without regard to whether the result is imposition or relief from taxation, the Courts have recognized that where the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority.”

In the case of **Helvering vs. New Haven & S. L. R. Co.**, 121 Fed. (2d) 985, 988, certiorari denied, 315 U. S. 803, as to a reorganization there involved, the Court said:

“As for the effort of the Commissioner to atomize the plan, as it were; i. e. to separate it into its several

steps and treat the last as though it stood alone, it has been repeatedly repudiated."

In one of the cases probably most frequently cited in support of the rule, **Prairie Oil & Gas Co. vs. Motter**, 66 Fed. (2d) 309, it was said on page 311:

"If a taxpayer sought to avoid a tax on the profits of such sale as this by asking the Commissioner to ignore the actualities, he would shortly and properly be reminded that taxation is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern."

Other authorities holding to similar effect are listed as follows:

**Commissioner vs. Griffiths**, 103 Fed. (2d) 110,  
affirmed in 308 U. S. 355;

**U. S. vs. Collier**, 105 Fed. (2d) 420;

**Berwind vs. Commissioner**, 137 Fed. (2d) 451;

**Early vs. Southgate Corp.** 136 Fed. (2d) 217;

**U. S. vs. Phellis**, 257 U. S. 156; 66 L. Ed. 180.

Bearing in mind that the main issue here involved is the question of law as to the "cost" of the property upon which gain or loss arising from a subsequent sale should legally be computed, let us review the evidentiary sequence of the steps taken by the Auto Company in the purchase of this property as reflected in the fact findings of The Tax Court and the Circuit Court and which must, under the rule announced in the above cited cases, be viewed as a whole. They were as follows:

(1) That the fair market value of the property at the time of its acquisition by the Auto Company in 1922 was \$45,000.00 is evidenced by the fact that the building on the land was valued in 1923 and for fourteen consecutive years thereafter at \$25,000.00 for depreciation purposes in the income tax returns of the Auto Company, and such valuation was accepted by the Commissioner. This improved realty, with the building thereon aged an additional

seventeen years, sold in 1939 for \$36,000.00, a fact which in and of itself supports a 1922 fair market value far in excess of the \$20,000.00, to which the Commissioner confined the cost, and in line with Petitioners' contention.

(2) At the time of the conveyance Blacknall and his associates owned the property. He and his associate companies owed Hulick a \$10,000.00 note secured by a first lien thereagainst, and Pease a \$10,000.00 note secured by a second lien thereagainst. In addition to this lien indebtedness, he and his associate companies owed the Bank \$24,567.16, evidenced by six unsecured notes.

(3) At the time of the conveyance, Pease owned 45 per cent of the Auto Company stock, subsequently acquiring the remainder. Pease likewise owned 315 shares out of the 345 shares of the capital stock of the Bank.

(4) The consideration paid and to be paid the Blacknall interests for the property, as recited in the deed itself, was "\$10.00 and other valuable consideration," and "subject to all indebtedness thereon." The lien indebtedness amounted to \$20,000.00, thus leaving a value in the property of \$25,000.00 for which Blacknall was to be compensated by "other valuable consideration."

(5) At the time of the conveyance by Blacknall to the Auto Company it was orally agreed between him and his associate companies, on the one hand, and the Bank and Pease, on the other, that if Blacknall should have the property conveyed to the Auto Company, he and his associates would be released and discharged from any and all direct or indirect liability to either the Bank or Pease.

(6) Seven days after the date of the conveyance to the Auto Company by Blacknall, this undertaking and obligation on the part of the Bank and Pease so to release Blacknall and his associates from direct or indirect liability, was reduced to writing and signed by Blacknall, his

associate company, J. C. Blacknall Company (named as vendor in the Auto Company's deed), the Bank and Pease, conditioned only that no bankruptcy proceedings were instituted against Blacknall or his associates. Manifestly Blacknall, after having performed his agreement to convey, was requiring written evidence of the obligation on the part of the Bank and Pease to release him from liability on the unsecured notes.

(7) In its Federal income tax for the year 1922, of necessity filed prior to March 15, 1923, some three months after the conveyance by Blacknall to the Auto Company, the Bank charged off as a loss an indebtedness of approximately \$25,000.00 against Blacknall and his associates, including the six notes referred to. In September, 1924, the said six notes were surrendered to Blacknall, he giving no further consideration therefor.

And thus was Blacknall compensated for the remaining \$25,000.00 value in the properties conveyed by him to the Auto Company. Neither the Bank's charge off, pursuant to its and Pease's agreement so to do, nor the Bank's bookkeeping methods can alter the evident facts of the transaction, or the true cost of the property. Evidently Pease's purpose in charging off the notes on the Bank's books was two-fold. Primarily to comply with his written obligation to Blacknall, and secondarily to adopt such a bookkeeping method as would be beneficial to himself by creating a "loss" for his bank deductible from its income tax return. Blacknall owned the \$45,000.00 value in the property and he received for it a total of \$45,000.00, represented by the two secured notes against the property and the six notes charged off. As stipulated and found by The Tax Court, the facts demonstrate that Blacknall's six notes, discharged and surrendered by the Bank, were worth their face value as used. He owed the money and paid them in full by the conveyance of the property.

In the case of **Farming Corporation vs. Commissioner**, 11 B. T. A. 1413, the taxpayer had sold certain farms for which it received cash payments, first mortgages and three second mortgages in the total face value of \$12,550.00. The second mortgages were not marketable save at a substantial discount, but were transferred to the corporation from which the taxpayer had purchased the farms and the taxpayer received credit therefor on his original purchase price in the amount of the face value of the mortgages. The taxpayer excluded the face value of the mortgages, so used, from its gross income. The Commissioner restored such value of \$12,550.00 to gross income, and was upheld by the Board of Tax Appeals on the ground that the mortgages had been used in paying off the purchase price, and were therefore "worth their face value to the petitioner."

Similarly, in the case at bar, the six unsecured notes in question were used by the Bank and Pease to the extent of their face value in paying off a part of the purchase price demanded by Blacknall, and The Tax Court and the Circuit Court erred in holding that neither the Bank nor Pease, in charging off and surrendering the notes, contributed anything of value to the Auto Company's purchase price.

A slightly different course, if pursued by Pease, would have accomplished the same legal effect. The Stockholders of a corporation are of course the true owners of the assets thereof. Pease owned the Bank or 21/23 of its stock, and likewise owned 45 per cent of the Auto Company's stock, subsequently acquiring the remainder. If Pease had deposited the money in his Bank to the Auto Company's credit with which to pay the six Blacknall notes, and then the Auto Company had given the Bank a check in payment thereof, or if Pease had personally paid the notes to the Bank, taken them up and, acting for the Auto Company, surrendered them to Blacknall, the result

would have been the same. In either or any event, when the Auto Company, acting through its own officers as such, or through Pease who owned its stock and that of the Bank, relieved Blacknall from liability on the notes, the amount is plainly "cost" of the property. Pease decreased the value of his Bank stock by the amount charged off, but, by the same token, he increased the value of his Auto Company stock by acquiring property of an equivalent value. Blacknall simply conveyed his property in satisfaction of his debt to Pease, the conveyance being made to the Auto Company at the direction of Pease and his Bank. It is true that it resulted in a contribution to its capital stock, but at the same time it was an effectual payment by Pease on behalf of his Auto Company for the realty in question, as a part of the "cost" thereof, equally as much so as was the subsequent satisfaction of Blacknall's lien indebtedness of \$20,000.00 against the property to which "cost" was confined by The Tax Court and the Circuit Court.

Hence, it is submitted that, in the light of the cases hereinabove cited, The Tax Court and the Circuit Court erred in not viewing collectively the related steps taken in the purchase of the property and in excluding from the "cost" thereof the six unsecured notes owed by Blacknall to the Bank, which as part of the consideration for the property, the Bank and Pease agreed to and did charge off and surrender to Blacknall.

Ancillary to the foregoing discussion, we further submit that

(1) The statute requires the value for the computation of depreciation to be the same as the basis for computing gain or loss in the event of sale (Section 114 (a), *supra*). The action of the Internal Revenue Department in accepting and agreeing upon the valuations made by the Auto Company in its income tax returns for fifteen consecutive

years following the purchase, allocating \$25,000.00 to the building alone for purposes of depreciation, is in itself sufficient proof of that value.

**James Mfg. Co. vs. Commissioner**, 17 B. T. A. 205;

**Farmers Cotton Oil Co. vs. Commissioner**, 27 B. T. A. 105;

**Couzens vs. Commissioner**, 11 B. T. A. 1040;

**Brand vs. Commissioner**, 5 B. T. A. 297.

Furthermore, from an examination of these and related cases, it is apparent that there is no set formula for determining either "cost," or fair market value under Sections 113 (a) (2), any reliable evidence being acceptable in evidence thereof. It is likewise the law that knowledge of values by Internal Revenue Agents is imputed to the Commissioner. **Helvering vs. Schine Chain Theaters**, 121 Fed. (2d) 948. In the instant case, the Commissioner is in irreconcilable positions and therein has been upheld by The Tax Court and the Circuit Court. He fixes the 1922 "cost" for computing gain on the 1939 sale at \$20,000.00, allocating \$8,888.89 to cost of the land and \$11,111.11 to cost of the building. Meanwhile, beginning with taxpayer's purchase in 1922 and for the fifteen following years, he has accepted a valuation on the building alone of \$25,000.00 for depreciation purposes, which the law says shall be the same as the basis for calculating gain or loss from a sale, and has allowed during that time a total of \$16,417.30 as depreciation, which is more than \$5,000.00 in excess of what the Commissioner now claims was the cost of the building in 1922.

(2) Should it be held by this Court that the six notes of the face value of \$24,561.16 charged off by the Bank were not properly a part of the "cost" of the property as paid by the Auto Company or on its behalf, nevertheless The Tax Court and the Circuit Court have erred in hold-



ing that for the computation of depreciation and gain from the 1939 sale of the property, the "cost" basis is limited to the \$20,000.00 in lien indebtedness against the property actually paid off by the Auto Company, whereas under the very circumstance of such charge off the true and correct basis of cost would, under Section 113 (a) (2), be the fair market value at the time of the acquisition of the property by the Auto Company. The "cost" to the taxpayer **alone** is not the test.

**Detroit Edison Co. vs. Commissioner**, 131 Fed. (2d) 619; 319 U. S. 98;

**Arundel-Brooks Corp. vs. Commissioner**, 129 Fed. (2d) 762;

**Helvering vs. New President Corp.** 122 Fed. (2d) 92;

**Helvering vs. New Haven Co.**, 121 Fed. (2d) 988;  
315 U. S. 803;

**Majestic Securities Corp. vs. Commissioner**, 120 Fed. (2d) 12;

**Nashville Warehouse & Elevator Co. vs. Commissioner**,  
105 Fed. (2d) 990;

**Park vs. Commissioner**, 15 B. T. A. 106;

**Perkins vs. Commissioner**, 125 Fed. (2d) 150;

**Robinson vs. Commissioner**, 59 Fed. (2d) 1008;

**Rosenbloom vs. Commissioner**, 24 B. T. A. 763;

**Biscayne Co. vs. Commissioner**, 23 B. T. A. 731;

**Knight vs. Commissioner**, 28 B. T. A. 188;

**McDonald vs. Commissioner**, 28 B. T. A. 64;

**Eggink vs. Commissioner**, 7 B. T. A. 152;

**Milton vs. Mackay**, 11 B. T. A. 569;

**Robertson vs. Commissioner**, 5 B. T. A. 748.

(3) Taxing statutes should be construed and applied with a view of avoiding unjust consequences as far as pos-



sible. Neither the letter of the statute nor technical construction should defeat that purpose.

**Farmers Loan & Trust Co. vs. Minnesota**, 280 U. S. 204;  
74 L. Ed. 371; 65 A. L. R. 1000;

**Oats vs. First National Bank**, 100 U. S. 239;  
25 L. Ed. 580;

**Legg's Estate vs. Commissioner**, 114 Fed. (2d) 760.

(4) In the case at bar, the Petitioners have the burden only of showing that the computation of the income tax alleged to be due by them, as computed by the Commissioner and as affirmed by The Tax Court and the Circuit Court, is erroneous, and they do not have the further burden of establishing the **facts** upon which the tax may be correctly computed.

**Helvering vs. Taylor**, 293 U. S. 507; 79 L. Ed. 623;

**Wagner & Son vs. Commissioner**, 93 Fed. (2d) 816;

**National Lumber & Tie Co. vs. Commissioner**, 90 Fed. (2d) 216;

**Hague Estate vs. Commissioner**, 132 Fed. (2d) 215;  
318 U. S. 787.

Therefore, if, in the judgment of this Court The Tax Court and the Circuit Court have made no finding from the stipulated facts of a fact essential to a correct computation of the taxes alleged to be due, this cause should be remanded for further hearing as to what **was** the **true** fair market value of the property when purchased by the Auto Company in 1922.

**Commissioner vs. Laughton**, 113 Fed. (2d) 103;

**Seaside Imp. Co. vs. Commissioner**, 105 Fed. (2d) 990;  
308 U. S. 618;

**Coosa Land Co. vs. Commissioner**, 103 Fed. (2d) 555;

**Andrews vs. Commissioner**, 135 Fed. (2d) 314;

**Esperson vs. Commissioner**, 127 Fed. (2d) 370

In conclusion and in explanation of the plea for alternative and equitable relief, or an offset, urged in the lower courts by the transferees Petitioners Vandenberg, Blackburn and Wallace, we suggest that the same was grounded upon the fact that they severally reported and paid individual income taxes for the year 1939 on a liquidating dividend of \$19,500.00, declared by the Auto Company as a result of the sale in that year of the property involved, each of the three reporting and paying taxes, in varying brackets, on \$6,500.00 received from this source, the taxes so paid amounting in the aggregate to \$680.82 (R. 36). This plea was denied by both The Tax Court and the Circuit Court (R. 40-42, 60-61). Such holding is doubtless correct under the decision of this Honorable Court in the case of **Commissioner vs. Gooch Milling & Elevator Co.**, 320 U. S. 418, and the claim for such equitable relief is therefore abandoned in so far as this particular proceeding is concerned.

\* \* \* \* \*

### PRAYER

WHEREFORE, premises considered, Petitioners pray as in their foregoing Petition for Writ of Certiorari.

Respectfully submitted,

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## INDEX

Opinions below .....	Page
Jurisdiction .....	1
Question presented .....	1
Statutes involved .....	2
Statement .....	2
Argument .....	4
Conclusion .....	7

### CITATIONS

#### Cases:

<i>Arundel-Brooks Concrete Corp. v. Commissioner</i> , 129 F. 2d 762.....	6
<i>Detroit Edison Co. v. Commissioner</i> , 319 U. S. 98.....	6
<i>Elmhurst Cemetery Co. v. Commissioner</i> , 300 U. S. 37.....	5
<i>Friend v. Commissioner</i> , 119 F. 2d 959, certiorari denied, 314 U. S. 673.....	6
<i>Kell v. Commissioner</i> , 88 F. 2d 453.....	6
<i>Nashville Warehouse &amp; El. Corp. v. Commissioner</i> , 105 F. 2d 883.....	6
<i>North American Coal Corp. v. Commissioner</i> , 28 B. T. A. 807.....	6
<i>Robinson v. Commissioner</i> , 97 F. 2d 552.....	6

#### Statutes:

Internal Revenue Code:	
Sec. 113 (26 U. S. C., Sec. 113) .....	2, 4
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 113 .....	2, 4

24

# **In the Supreme Court of the United States**

OCTOBER TERM, 1944

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No. 1247

J. V. VANDENBERGE ET AL., TRANSFEREES OF  
TEXAS AUTO COMPANY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH  
CIRCUIT

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

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## **OPINIONS BELOW**

The opinion of the Tax Court (R. 31-42) is reported at 3 T. C. 321. The opinion of the Circuit Court of Appeals (R. 57-59) is reported at 147 F. 2d 167.

## **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on February 12, 1945. (R. 60.) The petition for a writ of certiorari was filed on May 8, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether the cost of property within the meaning of Section 113 (a) of the Revenue Act of 1938 and the Internal Revenue Code is limited to the consideration paid by the purchaser in acquiring the property.

### STATUTES INVOLVED

#### Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—  
The basis of property shall be the cost of such property; except that—

\* \* \* \* \*

(26 U. S. C., Sec. 113.)

The corresponding section of the Revenue Act of 1938, c. 289, 52 Stat. 447, is substantially the same as the above.

### STATEMENT

In 1922 the Texas Auto Company, 45% of whose stock was then owned by Clark Pease, purchased certain improved real estate from the J. C. Blacknall Company. The property was deeded for a recited consideration of \$10 "and other valuable consideration" and "subject to all existing indebtedness thereon." (R. 33.) The Blacknall Company was indebted on two notes aggregating \$20,000, which were secured by liens on the property conveyed. These notes were subsequently paid by the Auto Company. (R.



33-34.) Blacknall and his associated companies were also indebted to the City National Bank of Corpus Christi, Texas, of which Pease was president and controlling stockholder, on six unsecured notes aggregating \$24,567.16. It was agreed between Blacknall, his associated companies, Pease and the bank that this indebtedness would be released and discharged upon conveyance of the property here involved to the Auto Company. This discharge was effected, the six notes being delivered to Blacknall in 1924 without his giving further consideration. In its 1922 income tax return the bank charged off as worthless an indebtedness of approximately \$25,000, including the six notes, against Blacknall and his companies, and the bank has failed to make any substantial recoveries on this indebtedness. (R. 34.)

The Auto Company ascribed, for depreciation purposes, a cost of \$45,000 to the property acquired from J. C. Blacknall Company, allocating \$20,000 to the land and \$25,000 to the improvements. Depreciation on the building was claimed and allowed in the aggregate amount of \$16,417.30 for the years 1923 to 1937, inclusive. In July, 1939, the Auto Company sold the property for \$36,000. (R. 34-35.)

In determining deficiencies of the Auto Company's income and excess profits taxes for 1938 and 1939, the Commissioner of Internal Revenue allowed an original cost of only \$20,000 for the property involved, based on the secured notes

which were paid by the Auto Company in discharging indebtedness on the property. The asserted additional cost of about \$25,000, represented by the six unsecured notes surrendered by the bank, was disallowed. Employing this lower allowed cost as a basis, the Commissioner determined that a net gain of \$27,111.11 resulted from the 1939 sale, or \$10,000 in excess of that reported by the Auto Company; and also disallowed a claimed depreciation of \$1,400 for the building in 1938. (R. 35.) The Tax Court sustained the Commissioner's determination (R. 36-39) and this decision was affirmed by the Circuit Court of Appeals (R. 57-59).

#### ARGUMENT

In holding that the basis of the property was limited to the \$20,000 paid by the Auto Company in discharging the indebtedness thereon, and did not include the value of the unsecured notes surrendered to Blacknall by the bank, the court below rendered a decision which was correct and which does not call for further review.

The statute establishing the unadjusted basis of property for purposes of both depreciation and capital gain or loss provides that "the basis of property shall be the cost of such property." Section 113 (a), Internal Revenue Code and Revenue Act of 1938, *supra*. The Circuit Court construed this statute to mean that the cost of property is the price paid to acquire it. It then concluded that in

the present case "the only consideration paid by the purchaser was \$20,000, and no other consideration passing anything of value moved to the seller from any one else." (R. 59.) This conclusion was predicated upon a finding by the Tax Court that the six notes surrendered to Blacknall by the bank were without value. The court below accepted this finding as conclusive, since it was based upon the action of the bank in charging off the indebtedness as worthless and the further fact that no recovery had been made on the notes prior to their surrender, and since there was no evidence to the contrary. Inasmuch as this finding as to value involved a factual determination, the court below properly refused to disturb it on review. *Elmhurst Cemetery Co. v. Commissioner*, 300 U. S. 37.

In view of the conclusively found fact that no consideration other than the \$20,000 moved to Blacknall, the court below correctly ruled that this price constituted the cost basis of the property within the meaning of the statute. Moreover, it was unnecessary for the court to decide the question whether the value of the six notes surrendered by the bank should be included in the cost basis or whether cost as used in the statute is limited to cost to the taxpayer, for such a question would be meaningful only if the notes were of value. Hence to the extent that the grounds relied upon by petitioners for allowance of this writ are addressed to this question (Pet.

6), they are not responsive to the decision below. But even if this issue be considered as passed upon by the Circuit Court of Appeals, it is submitted that it was correctly decided.

Limitation of a taxpayer's basis to his own investment in property has been sanctioned by this Court and consistently recognized by other courts. See *Detroit Edison Co. v. Commissioner*, 319 U. S. 98; *Nashville Warehouse & El. Corp. v. Commissioner*, 105 F. 2d 883 (C. C. A. 6th); *Robinson v. Commissioner*, 97 F. 2d 552 (C. C. A. 9th); *Kell v. Commissioner*, 88 F. 2d 453 (C. C. A. 5th); *North American Coal Corp. v. Commissioner*, 28 B. T. A. 807; cf. *Friend v. Commissioner*, 119 F. 2d 959 (C. C. A. 7th), certiorari denied, 314 U. S. 673. In the *Detroit Edison* case, prospective customers made payments to an electric company to defray estimated expenses of constructing facilities needed to serve customers. It was held that these contributions should be excluded from the company's basis for depreciation purposes. In sustaining a basis reflecting the company's net investment, which was less than the value of the property acquired, this Court stated (p. 102): "But we think the statutory provision that the 'basis of property shall be the cost of such property' (§ 113 (a)) normally means, and that in this case the Commissioner was justified in applying it to mean, cost to the taxpayer."

The rationale of *Arundel-Brooks Concrete Corp. v. Commissioner*, 129 F. 2d 762 (C. C. A.

4th), upon which petitioners place principal reliance (Br. 12-19), is that cost as used in the statute refers to total cost of the assets and not net cost to the taxpayer. But this rule, we submit, cannot be reconciled with the *Detroit Edison* holding, a conflict which was recognized by this Court in granting certiorari in the *Detroit Edison* case. The basic factual distinctions between the two cases are certainly not substantial enough to support petitioners' assertion that this Court has in effect affirmed the *Arundel-Brooks* rationale. (Br. 18.)

#### CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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SAMUEL O. CLARK, Jr.,  
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*Special Assistants to the Attorney General.*

JUNE, 1945.